taxnotes®
state & local
Volume 87, Number 12 ■ March 19, 2018

Retaining the Remote Retail Sales Tax Exemption Would Boost Growth

by Ike Brannon

Reprinted from *State Tax Notes*, March 19, 2018, p. 1103

Retaining the Remote Retail Sales Tax Exemption Would Boost Growth

by Ike Brannon

Ike Brannon

Ike Brannon is the president of Capital Policy Analytics and a visiting senior fellow at the Cato Institute.

In this viewpoint, Brannon argues that requiring all online retailers to collect and remit sales tax could stifle the kind of innovation that has made Amazon.com incredibly efficient and a boon to the U.S. economy.

Introduction

There is a perception expressed by many that exempting online, out-of-state retailers from state sales taxes has been a bad thing for the economy,[1] or more specifically, a bad thing for the economies of small towns and rural localities.[2] Those who advocate this line of thought assert that the remote sales tax limitation has contributed to an overall decline in state sales tax revenue over the past two decades[3] and has contributed to the decline in family-owned retailers that have been the bedrock of small-town communities.[4] They also argue that the limitation creates an unfair competitive advantage for remote retailers, who — they allege — already have the competitive advantage of not having to incur the costs of operating a physical store.[5]

This perception is largely incorrect. The sales tax exemption for remote retailers is not the primary reason that small, independent bricks-and-mortar stores have been slowly declining. The cost advantages that large retailers can achieve over small retailers have been a driving force in this market since the 19th century. The allegations now directed at Amazon were first leveled at Walmart, Montgomery Ward, the Sears catalog, and others.

What's more, being remote provides a retailer no practical advantage at all over local retailers. Amazon's transformation into a retailer that provides prompt delivery and customer service has become possible only by its having a presence in hundreds of communities across the country. Ultimately, it is necessary for major retailers to have the infrastructure to be close to the customers.

The last epochal change in retail before Amazon's aura of supremacy resulted from Walmart's incessant push to improve its productivity. Much of Walmart's gains resulted from its rapid adoption of information technology advancements, which it used to improve its management of inventory and streamline its logistics. Walmart also pushes its myriad suppliers to constantly reduce their wholesale prices, and ceaselessly seeks out vendors willing to charge lower prices than its current suppliers. Walmart's successes forced its retail competitors to follow suit and increase

[1] *See* Arthur B. Laffer and Donna Arduin, "Pro-Growth Tax Reform and E-Fairness," Let Freedom Ring (July 2013).

[2] *See* Ben Schiller, "Is Amazon Killing Jobs and Destroying Communities?" Fast Company, Dec. 2, 2016.

[3] Arielle Dreher, "Lost Revenue: Closing the Amazon Tax Loophole," *Jackson Free Press*, Oct. 12 2016.

[4] Janet Cho, "Amazon's explosive growth endangers small businesses, local stores: study says," *Cleveland Plain-Dealer*, Dec. 3, 2016.

[5] "Marketplace Fairness Act Aims to Level Playing Field," Tennis Industry Association, Jan. 2014.

productivity or else develop clearly defined differentiation strategies.[6] Those that were unable to do so rapidly enough lost market share and profits, and many of them went out of business. Several iconic retailers operating today may soon meet the same fate.

The ability of Amazon, and before that Walmart, to continually increase productivity is best viewed as a recent manifestation of a much longer-running trend of increasing retail sector productivity, defined as sales per employee-hour. These productivity gains have been a boon for the U.S. economy. Productivity growth is the essential ingredient for improving standards of living in the United States, and there is ample evidence that retail productivity gains are far more important than in any other sector of the economy. A company that improves its productivity becomes more profitable; an industry that becomes more productive increases output with the same, or less, labor. That means there is more labor available for other economically productive activities elsewhere.

Established businesses folding under the competitive pressures of new, innovative firms is not a crisis in a market economy — the constant churn may be a necessary outcome for economic growth. Esteemed economist Joseph Schumpeter famously observed that such creative destruction is essential to the health of a vibrant economy. In 2017 Amazon added groceries to its potential growth areas. It is hard to overstate the company's potential impact on commerce.

Today, Walmart and Amazon are the two dominant U.S. retailers. Walmart's sales exceeded $500 billion in 2016, making it the largest retailer in the country by far. Amazon's 2016 sales were only $130 billion, but its sales growth, both the rate and in absolute dollar terms, exceeded that of Walmart or any other major U.S. retailer. Its internet sales — 43 percent of the online market — dwarfed those of its online rivals.

The more important portent of future growth is the enormous disparity in worker productivity between Amazon and its rivals. While Amazon's revenues may be only one-quarter of Walmart's, its productivity — measured as sales per employee-hour — is twice that of Walmart, which is commonly viewed as the retail efficiency expert. This gap worries other U.S. retailers and many government regulators. With Amazon possessing such an enormous advantage over its current rivals, is it realistic to think that any of them will be able to transform their operations and compete? If not, will Amazon amass so much market share that the government is compelled to force the company to divest itself of some assets?

As we enter a new era of retail, one that looks as if Amazon will be the predominant player, another question arises: What will be the origin of Amazon's future retail disruptor? The answer is that if a new company knocks Amazon from its perch, it will likely be a company that begins by selling goods and services online. However, an economy in which remote sellers must collect sales tax may make that feat more difficult to accomplish. A sales tax imposed on small, remote retailers would significantly increase their costs of doing business, thereby making it more difficult for them to grow and compete against the entrenched incumbents.

Amazon collects sales taxes in every state that has one, primarily because it has radically changed its business model — it now has facilities throughout the country, which it concluded were necessary to achieve the necessary level of service. A primary driver of Amazon's business model is a constant effort to improve reliability and reduce delivery times. Constructing distribution centers, lockers, and (perhaps) drone squadrons and fleets of unmanned trucks throughout the country has been central to its strategy. For Amazon, the cost of collecting and remitting sales taxes has become a secondary consideration relative to the immense benefits of its hyperefficient distribution network.

In fact, nearly all the biggest online retailers collect sales taxes in every applicable state because they have a physical presence across the country, primarily in the form of their retail stores. They too must be close to their customers to remain competitive. Who is left without any nexus? It is exclusively remote retailers, who are often small and emerging.

Mandating that remote retailers pay a sales tax on their out-of-state sales would create a

[6]"Thinking Outside the Box: As American Shoppers Move Online, Wal-Mart Fights to Defend Its Dominance," *The Economist*, June 2, 2016.

significant barrier to future Amazon disruptors. As a result, a main engine of economic growth in the United States — the rapid retail sector productivity gains created by keen competition from aggressive new entrants — could diminish in an environment where new firms face significant barriers to entry.

A primary value that has long distinguished American capitalism is that it has ensured space for the new entrant to disrupt incumbents and the status quo. Forcing small businesses without nexus to collect and remit taxes will handicap their growth from the outset, which is precisely what incumbent players such as Amazon want. By eliminating the nexus requirement and taxing every sale by every retailer no matter how tangential its link to a state, policymakers risk effectively pulling up the drawbridge on new entrants that could disrupt Amazon.

Quill and Out-of-State Retailers

The current law regarding taxation of online sales was upheld in the U.S. Supreme Court's 1992 decision in *Quill Corp. v. North Dakota*.[7] Quill was a Delaware-based corporation with offices and warehouses in Illinois, California, and Georgia. It sold office equipment nationwide through a catalog.

North Dakota law required every retailer maintaining a place of business in the state to collect and remit tax. In 1987, North Dakota changed its law to expand the definition of retailer to include every person who engages in regular or systematic solicitation of a consumer market. Using this new authority, North Dakota sent a bill to Quill requesting the remittance of taxes on its sales in the state. Quill responded that it lacked nexus in the state because it had no physical presence or employees, and was therefore not required to collect sales taxes from its North Dakota customers.

Quill's response was grounded in the 1967 *Bellas Hess* case.[8] National Bellas Hess, like Quill, was a catalog company. The Supreme Court ruled that the commerce clause prohibits states from demanding the collection of use taxes from any company whose only connection to the state is by common carrier or mail.

When the North Dakota Supreme Court heard *Quill*, it ruled against the company, partly because the economy had changed since 1967. The U.S. Supreme Court disagreed with the state court, deciding that physical presence nexus remained the appropriate standard. At least part of the Supreme Court's rationale in upholding the nexus requirement was that empowering states to charge tax on remote sellers would create a crushing compliance burden on remote sellers.

At the time of *Quill*, there were 6,277 separate sales tax jurisdictions in the United States[9] — by 2014, there were 9,998.[10] If each jurisdiction required remote sellers to collect and remit sales tax, companies would be saddled with substantial new costs, undermining interstate commerce. The effect would be particularly negative for small and emerging companies.

The Evolution of Retail And Lost Sales Tax Revenue

The most common argument for imposing sales tax on out-of-state retailers is that the significant costs to state governments force them to cut back on services and pursue other revenue. However, the data do not support this assertion. Online sales represent a relatively small proportion of U.S. retail sales. The U.S. Census Bureau estimated that number was about 8.3 percent in 2017.[11] Excluding automobiles and fuel sales would raise this proportion to 11.7 percent.[12]

For decades economists have been wrongly predicting dire consequences for states because of their lack of a sales tax on retailers without nexus. For example, William F. Fox and LeAnn Luna (2000) contended that revenue losses were appreciable at the turn of the millennium, and they forecasted that these losses would only grow

[7] 504 U.S. 298 (1992).

[8] *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).

[9] Chris Atkins, "Important Tax Cases: *Quill Corp. v. North Dakota* and the Physical Presence Rule for Sales Tax Collection," Tax Foundation (July 19, 2005).

[10] Joseph Henchman, "State Sales Tax Jurisdictions Approach 10,000," Tax Foundation (Mar. 24, 2014).

[11] U.S. Census Bureau, Department of Commerce release, "Quarterly Retail E-Commerce Numbers, 1st Quarter 2017," Nov. 17, 2017.

[12] Amy Gesenhues, "Report: E-commerce Accounted for 11.7 Percent of Total Retail Sales in 2016, Up 15.6 Percent Over 2015," Marketing Land, Feb. 20, 2017.

over time.[13] A 2009 report by Donald Bruce, Fox, and Luna estimated enormous future revenue losses from the exemption of out-of-state retail sales.[14] However, the overwhelming forces driving their numbers were the business-to-business sales, which dwarf retail sales in their model. The tax treatment of business-to-business sales is a question that is completely distinct from taxing out-of-state retail, and it is largely irrelevant to the issue at hand.

What's more, the forecasts of lost sales tax revenue from internet sales are invariably overstated, mainly because most major online retailers now collect a sales tax on all goods sold. They must do this because they effectively have nexus in all U.S. states. In other words, retail has changed in ways not predicted when the forecasts were made. Instead of more sales becoming remote, large retailers have become large online sellers.

The large growth of internet-only retailers never materialized, and in fact, the trend has gone the other way. Amazon has nexus and employees in all states that charge a sales tax[15] and is essentially a local retailer. In addition, Amazon's closest competitors for online sales[16] are also entities that have numerous retail establishments across the United States and thus must collect sales tax in most states. Apple, Walmart, and Macy's all have large online businesses as well as physical stores, forcing them to collect tax for virtually all their sales. Together, these four entities accounted for over 60 percent of the $220 billion of internet retail sales in 2016.[17]

Local retail has not been harmed by the internet — there is much more retail space per shopper in the United States than in any other developed country. The United States has 23.5 square feet of retail space per person. The next largest are Canada at 16.4 and Australia at 11.1 square feet per person.[18] Europe has just 2.5 square feet of retail space per capita, or barely 10 percent of the United States.[19] However, it appears that U.S. retail space is rapidly shrinking. Technology writer Derek Thompson estimates that as much as one-fourth of all extant malls will no longer exist in a decade, and numerous iconic U.S. malls have already gone bankrupt.[20] Some of this attrition, Thompson argues, stems from changing consumer habits. Shoppers are spending more money on technology, travel, and restaurants than consumers 20 years ago and less on clothing and accessories.[21]

Amazon's own pivot manifests this shift away from tangible things and toward services: It spends billions of dollars producing original television programming for Amazon Prime Video, provides a streaming audio app, and sells books and other publications via its Kindle, which can be delivered either through its own dedicated device or via its smartphone or tablet application.

California's meager revenue gains from the passage of its own affiliate nexus tax bill that applied to nearly all out-of-state retailers, including Amazon, demonstrate the extent to which estimates of lost revenue are overstated. The new law generated only $91 million in the fourth quarter in 2012, roughly 20 percent of what Bruce, Fox, and Luna anticipated. The explanation for the difference is that smaller internet retailers still managed to escape the tax,[22] a notion that is not credible, given that Amazon alone captures 43 percent of all online sales.[23]

Thus, the "leakage" from state sales tax obligations appears to be relatively low. Based on the top 10 internet retailers and a weighted-average state sales tax rate of 6 percent, the lost tax revenue can be no more than $5 billion per year, or half of what Bruce, Fox, and Luna forecast for

[13] "Taxing E-Commerce: Neutral Taxation Is Best for Industry and the Economy," *Quarterly Journal of Electronic Commerce*, Aug. 2000, p. 139-150.

[14] Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," University of Tennessee (Apr. 13, 2009).

[15] Sales by third-party vendors on Amazon and on Walmart's Marketplace may or may not charge sales tax, depending on the rules applicable to the third-party vendors.

[16] Arthur Zaczkiewicz, "Amazon, Wal-Mart and Apple Top List of Biggest E-commerce Retailers," *Women's Wear Daily*, Apr. 7, 2017.

[17] *Id.*

[18] Greg Murdock, "Morningstar Research Mall Monitor — Examining the State of U.S. Malls With Attention to Retail," LinkedIn, Oct. 11, 2016.

[19] Mark Bain, "America's Vast Swaths of Retail Space Have Become a Burden in the Age of E-Commerce," Quartz, July 19, 2017.

[20] Derek Thompson, "What in the World Is Causing the Retail Meltdown of 2017?" *The Atlantic*, Apr. 10, 2017.

[21] Hayley Peterson, "The Retail Apocalypse Has Officially Descended on America," *Business Insider*, Mar. 21, 2017.

[22] Korey Clark, "Online Sales Tax Push Continues Despite Disappointing Returns," *State Net Capital Journal*, Mar. 2013.

[23] "Amazon Accounts for 43 Percent of US Online Retail Sales," Business Insider Intelligence, Feb. 3. 2017.

2012. Sales taxes account for roughly 30 percent of all state revenues today and 1.5 percent of GDP, according to research published by the Urban Institute. These are roughly the same proportions as in 1977, before the internet existed.[24] I recognize that it is incorrect to say that the loss of sales tax revenue from online retailers is negligible. However, the loss is not as high as some have estimated and the compliance costs and full economic costs of collecting that additional revenue would be significant for America's economy and the myriad small and emerging companies.

Sales Taxes Harm New Retailers

What would be the impact of a newly introduced tax regime on small and emerging companies? Again, the Amazon experience may be instructive. A 2016 Ohio State University study of 275,000 households found that when Amazon imposes a sales tax, consumers spend 9.4 percent less on Amazon purchases, and 29.1 percent less on items priced over $250.[25] The Institute for Local Self-Reliance argued that if Amazon had been required to collect sales tax in every state before it had a nexus, the mandate would have had a significant impact on the company's growth.[26]

Some might suggest that the nexus requirement affords remote retailers an unfair economic advantage over local bricks-and-mortar companies. However, this is not the case. Since the widespread growth of the internet, different retail models have been tried. As discussed above, retail appears to be evolving toward a hybrid online/physical presence model. Large traditional retailers, such as Walmart, are becoming major internet sellers, and Amazon, previously an e-tailer exclusively, has transitioned to a retailer with an online and physical presence. Even the local used book shop is networked through sites such as AbeBooks.com. In short, everyone is in everyone else's market channel. This competition drives innovation, which in turn drives productivity.

It takes time for new market entrants to develop. Requiring them to collect and remit tax in every jurisdiction where they sell would significantly slow, if not kill, their growth. This means that they would not be in a position over the medium term to build the infrastructure and other attributes of a company establishing nexus. The corresponding significant employment growth that comes when companies scale up would also not materialize. At a minimum, in the shorter term, firms would likely opt to forgo serving more sparsely populated parts of the country. These jurisdictions would simply not generate enough sales to justify the compliance burden.

Taxation Will Not Solve the States' Budget Issues

The refrain of many state politicians that their budgets are being wrecked by untaxed internet retail sales misstates the real budget problems facing most states. Mayors and governors assert that taxing internet sales would raise billions of dollars for the largest communities in the country.[27]

Overall, state revenues have recovered from the Great Recession. The recession caused severe state budget problems, but by mid-2013 revenues had fully rebounded.[28] However, the aggregate figure tells an incomplete story — the data also reveal that only 31 states have higher tax collections today than at their peak before the downturn. California, Texas, and New York have found new avenues of growth, but Florida, which suffered a steep housing decline, continues to feel the downturn's reverberations. The slow rebound of revenue growth in the states in the upper Midwest is in part attributable to the continued decline in, and automation of, manufacturing.

More threatening to the states' financial health are their long-term unfunded obligations. In 2003, unfunded aggregate state pension liabilities amounted to 2.9 percent of personal income. By

[24] Norton Francis and Frank Sammartino, "Governing with Tight Budgets," Urban Institute, Sept. 10, 2015.

[25] Brian Baught, Itztak Ben-David, and Hoonsuk Park, "Can Taxes Shape an Industry? Evidence From the Implementation of the 'Amazon Tax'," National Bureau of Economic Research (Apr. 2014).

[26] Olivia LaVecchia and Stacy Mitchell, "Amazon's Stranglehold: How the Company's Tightening Grip is Stifling Competition, Eroding Jobs, and Threatening Communities," Institute for Local Self Reliance (Nov. 2016).

[27] Bill Chappell, "Online Sales Costs Cities and Counties Billions in Taxes, Mayors Say," National Public Radio, June 21, 2013.

[28] "Fiscal 50: State Trends and Analysis," The Pew Charitable Trusts (Oct. 17, 2017).

2013, this had risen to the equivalent of 6.9 percent of personal income. In 2003, the states had funded 88.5 percent of their total retirement obligations. By 2013, this had fallen to 71.8 percent.[29]

And these estimates likely understate the problem. Joshua Rauh estimates that the true unfunded liability owed to state and local government workers based on their current service and salaries is $3.85 trillion as of fiscal 2015, whereas governments report unfunded liabilities of $1.38 trillion under governmental accounting standards.[30]

It is understandable why state politicians would be attracted to the idea of taxing out-of-state sales. After all, studies such as the one by Bruce, Fox, and Luna promise them that there is a pot of gold at the end of this rainbow. Yet, like the mythical golden city of El Dorado, these riches never seem to appear. A real key to fixing state budget problems is growing more businesses that will go on to establish nexus and pay taxes. Choking off these firms before they reach the growth phase, which overturning *Quill* risks doing, helps no one.

E-Tailers Versus Local Retailers

Retail is ever evolving — from the Sears catalog, to big-box stores, to Walmart's push for productivity, and Amazon's next-day delivery. However, recent changes are not simply internet versus bricks-and-mortar retail. Walmart, Target, Macy's, and Home Depot have large online retail businesses, but they are fundamentally bricks-and-mortar retailers with stores in their communities. Local retailers still constitute an enormous proportion of total U.S. retail sales. Consumers have shown through their shopping behavior that they prefer to "buy local" (defined broadly). This isn't simply a manifestation of parochial loyalty; they place a high value on related services such as ease of returns and repairs and the preference for immediacy. Having a local presence makes these services more cost-effective for retailers to provide while often being more convenient for consumers as well.

Taxing Remote Retailers Will Harm the Economy

One unavoidable economic truth is that productivity is ultimately the key determinant of long-term economic growth and our standard of living. The United States may have economic problems but our standard of living is, on average, higher than in virtually all the rest of the world. This is primarily because our worker productivity exceeds that of most other countries. In fact, the gap between the United States and Western Europe has been growing since the early 1980s. Japan enjoyed four decades of strong economic growth and almost caught the United States in the late 1980s before its economy faltered. Since then, the U.S. growth rate has exceeded Japan's.

There are numerous reasons why the United States has maintained higher economic growth in the past three decades than nearly every other developed economy — higher birth rates and immigration numbers have contributed to stronger labor market growth. There is also considerable evidence that economic growth has been driven, at least in part, by the productivity differences in the retail sector. An in-depth study by the McKinsey Global Institute that looked at productivity in the retail sector and numerous other industries in the United States and several other developed countries found overwhelming evidence that the level of freedom in the retail sector is a key determinant of productivity growth.[31] The retail sector is important because the competitive pressures in that industry filter down to suppliers, and in turn to their suppliers as well.

Other economists have come to a similar conclusion. Jason Furman, who chaired President Obama's Council of Economic Advisers, wrote[32] that the productivity gains wrought by Walmart's quest to boost its efficiency — which in turn forced its competitors and suppliers to do likewise — reduced the cost of living for the average American family by thousands of dollars

[29] *Id.*

[30] Joshua D. Rauh, "Hidden Debt, Hidden Deficits: 2017 Edition, How Pension Promises Are Consuming State and Local Budgets," Hoover Institution (May 15, 2017).

[31] James Manyika, Jaana Remes, and Jonathan Woetzel, "A Productivity Perspective on the Future of Growth," *McKinsey Quarterly*, Sept. 2014.

[32] Jason Furman, "Wal-Mart: A Progressive Success Story," New York University's Wagner Graduate School of Public Service, Nov. 28, 2005.

a year, which, he averred, represented a tremendous gain for working class families.

The United States puts few limits on retail competition. It does not limit the size of establishments, regulate their hours or the prices they charge, or dictate when retailers can have sales and how much they can reduce prices. As a result, it is easier for a new retailer to develop and expand in the United States than in most other places. For example, in Japan there are strict limits regarding the size of retailers, and large U.S. retailers have found it difficult to break into that market. In Germany stores cannot be open on Sunday[33] and the state limits the number of hours a store can be open to 72 per week. Austria has similarly restrictive laws. In France there can only be two sales per year, and the state strictly limits price competition among retailers.[34]

As a result, worker productivity in the U.S. retail sector is much higher than in Europe and Japan. William Lewis, the founding director of the McKinsey Global Institute, estimated that the average Japanese retail worker was 39 percent less productive than the average U.S. retail worker. In Europe those figures are higher but not appreciably so.[35]

Today, the retailer pushing the forefront in productivity improvements is not Walmart, but Amazon, along with a group of other retailers who primarily sell goods online. Part of the reason is that despite Walmart's almost obsessive attention to detail to boost profits, Amazon's productivity far exceeds Walmart's. Last year Walmart's sales per employee — a proximate gauge for productivity in the retail sector — was approximately $51,000. For Amazon, that number was $102,000.[36] This yawning productivity chasm suggests that unless Walmart, Target, and any other large retailers discover a way to dramatically improve their productivity, they may find themselves in the same position as Sears, Kmart, and J.C. Penney.

[33]"Shopping Hours in Germany," The German Way & More (undated).

[34]Patrick M. Dunne, James F. Carver, and Robert F. Lusch, *Retailing* (2010) at 171.

[35]William Lewis, *The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability* (2004).

[36]Adam Levy, "Amazon Generates Twice as Much Revenue Per Employee as Wal-Mart," The Motley Fool, June 26, 2017.

Bricks-and-mortar retailers clearly recognize this and have been attempting to reorganize themselves to more closely resemble Amazon's operating model. For instance, both Target and Walmart now offer free delivery of most items in two days, and Walmart now has its own version of Amazon's Marketplace, where other sellers can offer their goods alongside Walmart's offerings. What's more, Walmart is beginning to reduce its retail footprint, recognizing that having huge stores with their immense overhead is no longer all that advantageous.[37] Instead of carrying a vast array of products, it makes more sense for Walmart to encourage its customers to consult its webpage for uncommon goods and purchase them there. The customer can pick the goods up at the nearest store (and make returns there) or have them delivered in a day or two. Walmart will keep and continue improving its distribution network, of course, but its transformation is inexorably unfolding into a business model that closely resembles Amazon's.

At the same time, Amazon has been transforming its business model to further improve its delivery capabilities. Besides its free two-day delivery with an Amazon Prime membership, in many markets its customers can get many goods delivered the next day for free, and in a few markets some goods ordered before 10 a.m. can be delivered the same day. There is every expectation that the company intends to expand its next-day delivery options to include more goods and more customers — perhaps via a fleet of driverless trucks or autonomous drones in the not-so-distant future.

It is unclear whether Walmart or Target will ever be able to achieve anything near Amazon's productivity as they struggle to catch up. Amazon's enormous advantage in this metric may deteriorate, but it would have to deteriorate at a rapid clip for something approaching parity to occur.

Fostering Retail Market Competition

Amazon is indisputably the behemoth of the retail market. Practically every U.S. retail business

[37]Hiroko Tabucho, "Wal-Mart to Close 269 Stores as Retailers Struggle," *The New York Times*, Jan. 15, 2016.

must consider how to compete with Amazon or accommodate it, and an increasing number of non-retail companies fear that as it continues evolving into something akin to a conglomerate, Amazon will enter their business sector — potentially performing better than they can. However, the history of retail since the 19th century reveals a constant churn. The leader — whether it be Woolworths, Sears, Kmart, or Walmart — dominates the industry for a time, but invariably finds itself toppled by an upstart.

It is a history that Amazon's founder, Jeff Bezos, is aware of. His 2017 letter to shareholders discusses his obsession with trying to keep people at the company working as if the company is on "Day One" of its history because, as he puts it, "Day Two is stasis. Followed by excruciating, painful decline. Followed by death."[38]

The question is: where might Amazon's eventual challenger come from? The logical answer is that it will likely develop via the internet, much like Amazon did. If that is the logical path, a sales tax on remote sellers would represent a significant obstacle to such an upstart because it would constitute a significant increase in the e-tailer's costs.[39]

Amazon clearly recognizes this future threat to its dominance, and because of it, has strategically shifted its opinion on recent legislative developments. Until the 2013 introduction of the Marketplace Fairness Act (MFA), Amazon had opposed all bills seeking to impose a tax on online sales. The MFA would authorize states to compel out-of-state businesses to collect and remit sales tax. Amazon now supports the MFA and similar bills. Further, MFA proponents point out that 50 years after *Bellas Hess* and 25 years after *Quill*, calculating tax rates in thousands of jurisdictions is no longer an insurmountable technical, administrative, or financial burden.[40] Amazon has developed software that automatically calculates the tax rate based on the destination address and will provide such services to other e-retailers for a fee. Other firms provide similar software.

As an MFA proponent, Amazon is at odds with NetChoice, a coalition of e-commerce businesses and customers that includes eBay and Overstock.com. In essence, Amazon reaped its commerce clause benefits when it had a low nexus effects, but now wants to deny this opportunity for future entrepreneurs. Preserving an economy that fosters start-up businesses that can offer future competition to Amazon is essential. Requiring remote sellers to assess and remit sales tax in all the jurisdictions into which they sell will hamper their growth and lower the potential competition for Amazon.

Conclusion

The innovation in the U.S. retail sector has been an almost unparalleled economic boon for our society. The intense market competition has resulted in constant churn, as one company after another has taken its turn as the dominant leader, a pattern that has persisted for over a century. Economists believe that this competition has been a key reason for the strong productivity growth exhibited in the United States since we began measuring the statistic. This productivity growth, in turn, has been the key determinant of economic growth and our standard of living.

Today, Amazon seems poised to become the nation's leading retailer, based on its phenomenal growth and incredible productivity advantage over its rivals. It owes its market supremacy in no small part to its ability to transform its internet market into a store that provides its customers with prompt deliveries and excellent customer service, thanks to its physical expansion of retail hubs, so-called lockers, and warehouses.

The expansion of its physical footprint gives Amazon nexus in nearly every state, which means it is no longer exempt from collecting sales taxes. Amazon clearly calculated that the improvement in service it could achieve from having operations near its customers was worth paying sales taxes, and the company obviously made the right calculation.

However, new entrants into the retail market will be unable to compete against Amazon on service, at least not initially; they will need to compete by offering lower prices and minimizing

[38] Jeff Bezos, 2017 letter to Amazon.com shareholders (undated).

[39] It is easy to assume that a state sales tax is completely passed on to the consumer, and it doesn't matter who writes the check or what it says on a receipt. The retailer treats the tax as a cost of doing business, must bear its compliance costs, and faces penalties if the tax is unpaid.

[40] S. 698, Marketplace Fairness Act, 114th Cong. (2015).

their compliance costs. Repealing *Quill* and allowing states to require sales taxes from sellers without nexus in their state would make it that much more difficult for the new entrants to do so. A sales tax on out-of-state retailers could significantly dampen the creation and growth of new firms, which would lessen competition in the retail market, in turn reducing productivity growth and reducing or eliminating a key ingredient to U.S. economic growth. ■